Information from the Division of Health Care Finance and Policy

Quarterly Acute Hospital Financial Report, FY06 Q1

In FY06 Q1, hospital industry profitability dipped below FY05 levels. This decrease is primarily attributable to operating margin performance, which often dips in the first quarter. Further, while profitability decreased in FY06 Q1, fewer hospitals showed total losses. A large majority of the industry (82%) continued to comfortably meet short-term obligations and accounts receivable, and payment periods continued to improve. Finally, solvency was stable for the majority of the industry; however, the ability to cover long-term obligations remained a serious concern for just under one-third of Massachusetts hospitals.

About this Report

The Division of Health Care Finance and Policy (the Division) publishes quarterly acute hospital financial reports in response to a legislative mandate to provide an annual assessment of financial trends in the acute care hospital industry. Quarterly reporting is one part of the Division's ongoing program to better protect the public interest by continuously monitoring the financial condition of acute care hospitals. This report presents an industry-wide analysis from FY02 through FY06 Quarter 1 (Q1).[1,2] Financial trends for individual hospitals are on each hospital's Fact Sheet in the DHCFP Data Catalog at www.mass.gov/dhcfp.

Trends in financial ratio analysis can provide useful information about the hospital industry's financial condition. The three areas examined on a quarterly basis and discussed in this report are profitability, liquidity, and solvency.[3]

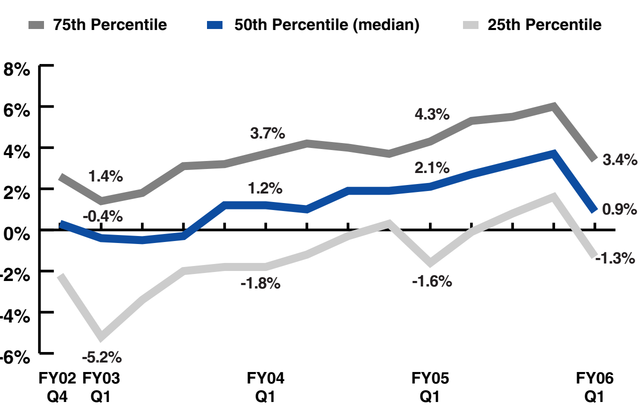
Profitability

Although most Massachusetts acute care hospitals are non-profit, they do need to generate a sufficient surplus in order to complete their missions, repay debt, and invest in the future of their organizations. Therefore, an analysis of the industry's profitability using three key ratios is reported here. Figures 1, 2, and 3 show FY02 through FY06 Q1 trends for 25th, 50th (median) and 75th quartile values[4] for Total Margin,[5] Operating Margin,[6] and Non-operating Margin.[7]

Profitability often dips in the first quarter of each year due to seasonal drops in utilization (see Figures 1 through 3). All three margins dipped in FY06 Q1, but both Total and Operating profitability levels were higher for the lower quartile than they were in FY05 Q1. Further, although levels were lower than the previous year for the upper two quartiles, fewer hospitals overall showed total losses when compared to FY05 Q1. For reference, Figure 4 provides annual measures of total profitability.

Figure 1

Total Margin Trend by Quarter, FY02-FY06 Q1

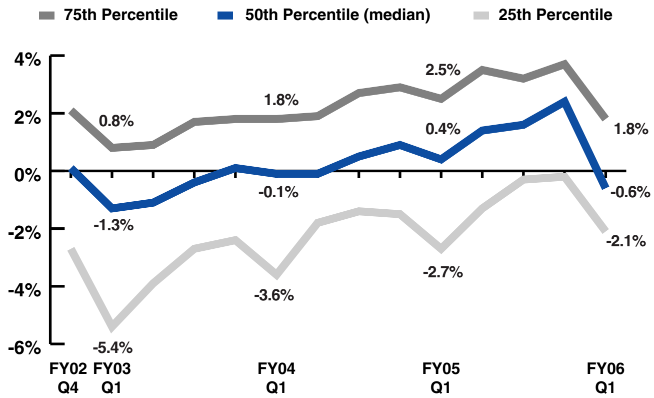


- **Overall profitability dipped across the industry in FY06 Q1; however, fewer hospitals experienced losses.**

Amy Lischko, Commissioner • Division of Health Care Finance and Policy • 2 Boylston Street • Boston, MA 02116
phone: 617-988-3100 • fax: 617-727-7662 • publications: 617-988-3125 • www.mass.gov/dhcfp

Figure 2

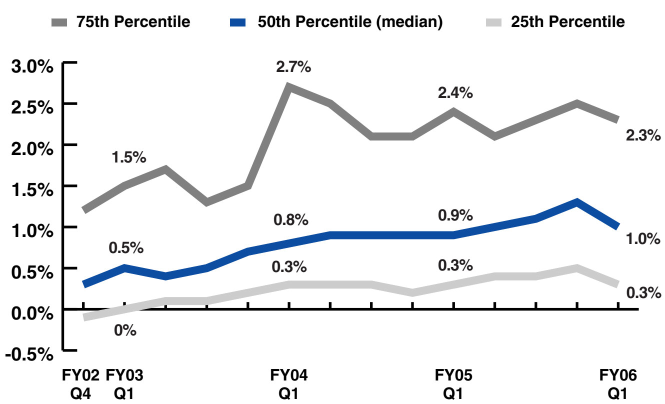
Operating Margin Trend by Quarter, FY02-FY06 Q1



- **Operating performance dipped across the industry in FY06 Q1. This is a predictable first quarter dip due to seasonal variations in volume.**

Figure 3

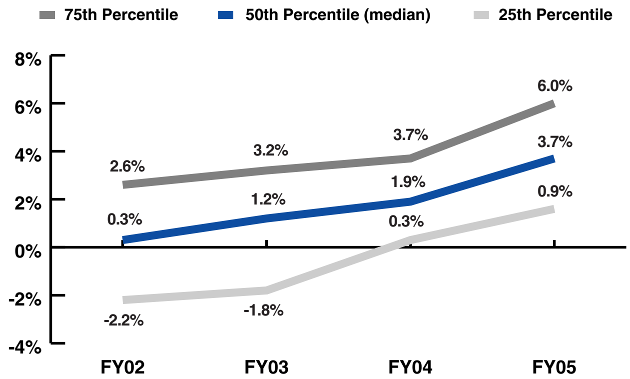
Non-operating Margin Trend by Quarter, FY02-FY06 Q1



- **Non-operating Margins decreased slightly in FY05 Q1, and six hospitals reported non-operating losses.**

Figure 4

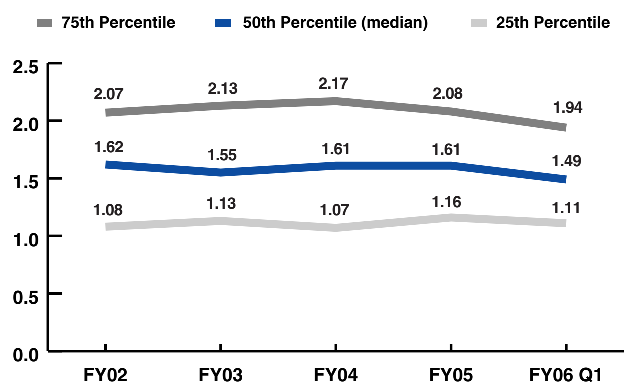
Annual Total Margin, FY02-FY05



- **Annual Margins are provided as a reference.**

Figure 5

Current Ratio Trend, FY02-FY06 Q1



- **Current Ratio decreased slightly across the industry; however, a majority of hospitals (82%) maintained Current Ratios above the 1.0 benchmark in FY06 Q1.**

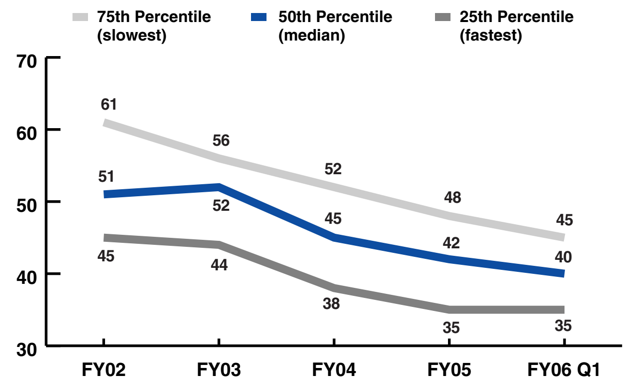
Liquidity

Liquidity ratios indicate a hospital's ability to meet its short-term obligations. Deterioration of these ratios is one indication of financial stress. Three liquidity ratios are reported here: Current Ratio,[8] Average Days in Accounts Receivable (A/R),[9] and Average Payment Period.[10] Figures 5, 6, and 7 show trends in quartile values for these three ratios.

Compared to FY05, the majority of hospitals demonstrated a slightly lower ability to meet current obligations in FY06 Q1; nevertheless, a large majority of hospitals (82%) performed above the 1.0 minimum benchmark (see Figure 5).[11] In addition, the industry showed more efficient management of Days in A/R (see Figure 6) and improvement in the average time to pay current liabilities (Average Payment Period,

Figure 6

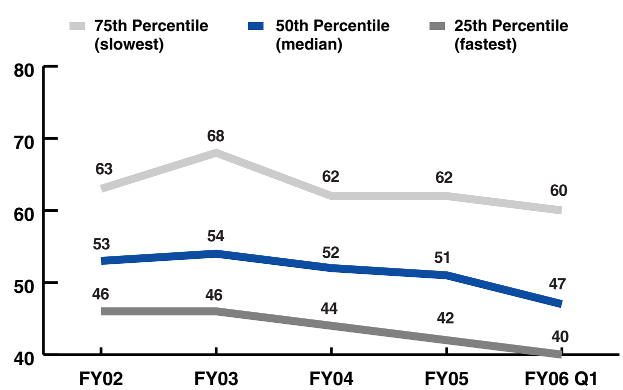
Days in Accounts Receivable Trend, FY02-FY06 Q1



- **Following the industry's positive trend since FY02, hospitals continued to improve collection of receivables in FY06 Q1. Median Days in A/R decreased by two days over FY05.**

Figure 7

Average Payment Period Trend in Days, FY02-FY06 Q1

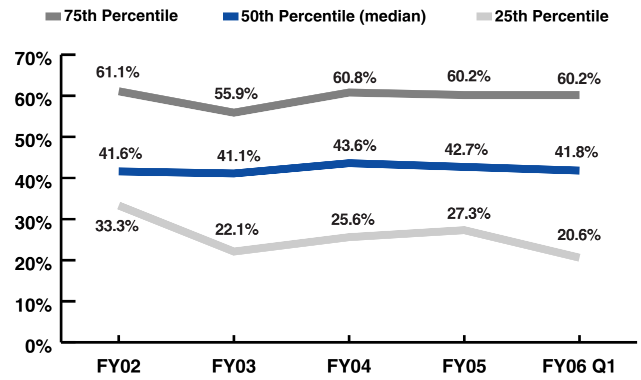


- **Average Payment Period decreased across all quartiles in FY06 Q1; however, close to 30% of hospitals paid current obligations at a faster rate than they collected receivables.**

see Figure 7) across all quartiles. Close to 30% of hospitals, however, are paying current obligations at a faster rate than they are collecting payments; this could lead to cash flow constraints for this group of hospitals in the future.

Figure 8

Equity Financing Trend, FY02-FY06 Q1



- **Equity Financing Ratios were stable for most of the industry in FY06 Q1; however, just under one-third of the hospitals were below the 30% benchmark. The highly leveraged position of some hospitals may make future asset acquisition difficult for this group.**

Solvency

Solvency ratios provide information regarding both how an organization finances its assets and how able an organization is to take on new debt. Deterioration of these ratios is another indication of problems in the financial health of an organization. Solvency ratios of Debt Service Coverage and Cash Flow to Total Debt are not included in this report because annualized data are necessary to accurately present these ratios. For quarterly analysis, only one solvency ratio is reported: Equity Financing.[12]

The Equity Financing ratio, measured by the proportion of total assets financed by equity, reflects the ability of a hospital to take on more debt. Low values indicate that a hospital is highly leveraged, and therefore, may have difficulty securing access to debt financing for further asset acquisition. Equity Financing remained stable for the majority of hospitals in FY06 Q1 compared to FY05 (see Figure 8); however this ratio was below the 30% industry benchmark for just under one-third of the hospitals, indicating long-term solvency issues for this group.

Teaching versus Non-teaching Hospitals

The Division also examines the financial health of teaching and non-teaching hospitals using financial ratio analysis. In terms of total and operating profitability, teaching hospitals outperformed non-teaching hospitals, with a lower percentage of teaching hospitals experiencing overall losses. In terms of non-operating performance, teaching hospitals showed higher levels of non-operating gains; however, a much larger percentage (31%) of teaching hospitals experienced non-operating losses (albeit small) compared to non-teaching hospitals. Only one non-teaching hospital experienced a non-operating loss.

Results were mixed with regard to liquidity. Median Current Ratio was slightly higher for teaching hospitals in the upper two quartiles; however, a higher percentage of teaching hospitals (25%) versus non-teaching hospitals (17%) experienced Current Ratios below the minimum industry benchmark of 1.0. Both teaching and non-teaching hospitals exhibited comparable improvement in collecting receivables due and paying current obligations.

Non-teaching hospitals may have more difficulty meeting interest and principal payments in the upcoming year as 35% (versus 25% for teaching hospitals) were below the 30% benchmark for Equity Financing in FY06 Q1. Non-teaching hospitals were slightly more leveraged than teaching hospitals, and there was some improvement in Equity Financing for the lower and middle quartiles of teaching hospitals.

Summary

Overall profitability dipped in FY06 Q1, as it often does in the first quarter of each year; however, for at least the lower quartile, profit levels were higher in FY06 Q1 than they were in FY05 Q1 and fewer hospitals overall showed total losses. Further, we expect profit levels to be more favorable in ensuing quarters. Although current ratio dipped slightly across the three quartiles, a majority of hospitals (82%) were still able to meet their current obligations. In addition, management of receivables improved across the industry, as did payment period. Finally, solvency was stable for most of the industry; however, the ability to cover long-term obligations remained a serious concern for just under one-third of Massachusetts hospitals.

Financial ratio values for each hospital are on the Hospital Fact Sheets in the Division of Health Care Finance and Policy Data Catalog at www.mass.gov/dhcfp. Hospital-specific dollar surplus or loss, net patient service revenue, total net assets, and assets whose use is limited are also provided on the Hospital Fact Sheets illustrating the magnitude of hospital surplus and loss, the size of operation, and the size of reserves.

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[1] The FY06 Q1 findings in this report are based on the financial filings of 65 acute care hospitals. One hospital (Mercy) has a fiscal year that ends on December 31, thus FY06 Q1 data were unavailable at the time of this analysis. Six other hospitals (Cape Cod, Falmouth, Massachusetts Eye and Ear, Nashoba Valley, North Adams, and Quincy) had not filed their FY05 annual filings at the time of this analysis; therefore, their FY05 data are not included in this report.

[2] *The AICPA Accounting and Audit Guide for Health Care Organizations* has changed the method of accounting and auditing for Alternative Investments. Where a hospital holds a 5% or greater ownership of such investments, the hospital must report these investments using the Equity Method. The effect of using the Equity Method is that income or losses from these investments will now be reported as non-operating gains (losses), as opposed to a change in net assets.

[3] Depending on the organization of each hospital, data may exclude other aspects of some hospitals' financial health, such as performance of endowments or the financial health of parent or other affiliated organizations.

[4] Quartile values can shed light on information about the distribution of financial ratio values across hospitals. Often, averages can be materially affected by outlier/extreme values at the low and high ends of a distribution. Examining quartiles, therefore, is a preferred means of assessing the overall distribution of values across hospitals. For instance, the ratio values of one-quarter of the hospitals at the low end of the distribution will fall at or below the 25th quartile value. Similarly, the ratio values of one-quarter of the hospitals at the high end of the distribution will fall at or above the 75th quartile value. The 50th percentile is the median, or the center of the distribution of values. Half of the hospitals' financial ratio values will fall below the median, and half will fall above the median. These quartile measures are particularly useful when a distribution is markedly skewed, or where it is generally symmetrical but includes a few outliers.

[5] Ratio of total income to total revenue.

[6] Ratio of operating income to total revenue.

[7] Ratio of non-operating income to total revenue.

[8] Ratio of current assets to current liabilities.

[9] Ratio of net patient accounts receivable to net patient service revenue/quarters of data * 91.25.

[10] Ratio of current liabilities less estimated third-party settlements to total expenses less depreciation and amortization/quarters of data * 91.25.

[11] A Current Ratio value of 1.0 indicates that a hospital has one dollar held in current assets per dollar of current liabilities. Values below 1.0 are considered strongly unfavorable and highlight an organization's illiquid position.

[12] Ratio of total net assets to total assets.

Publication Number: C.R. 1119